As Jana Busby, traffic manager for Media Valve Co., Inc. of Forth Worth, Texas, notes, shippers are living in a buyer's market, and therefore are likely to be able to wring concessions from their carriers. But dependence on transient market conditions is not the same as effective negotiating, and is likely to have negative repercussions when the market swings in the seller's favor.

Help From Above

Shippers stress that input from upper management is a better bargaining tool at the negotiating table. "We need to convince upper management that more details about the company's customers, suppliers, and future plans can lead to lower transportation costs and better service," says Ron Osborne, traffic manager at Fisher Mills, Inc.

This sentiment is echoed by the survey respondent who remarked that "Management at the top level has to realize that there is more to shipping than a telephone and a truck." Joseph Paul, warehousing manager for Rugged Wear, Ltd. in Wakefield, Ohio, adds "I need complete information on trends in the industry *before* they are told to me by my counterpart on the other side of the negotiating table."

The need shippers cite for more information from other departments within the company is just one element in the basics for effective negotiation listed by James Frazer, director of customer services for ECC America. The three requirements he identifies are: an understanding of the shipper's own real needs; an understanding of the carrier's needs; and an understanding of the customer's needs. The understanding and appreciation of the carrier's needs is a key concern Frazer shares with a majority of shippers.

A tactic often recommended by shippers cannot really be considered a part of the negotiating process, but is a useful precursor to a productive discussion. This tactic, used as a means of achieving the win/win strategy, is a reduction in the number of carriers being dealt with. By doing so, shippers can offer a more attractive amount of freight to the select carriers. With assurances of added volumes, carriers in turn can often offer bigger discounts and make service commitments that would under other circumstances be out of the question.

Something to Talk About

The content of the discussions between shippers and carriers, the survey indicates, rarely strays from the twin considerations of price and service (see chart 5). Liability accounts for a relatively minor part of the negotiating agenda, and such technical innovations as electronic data interchange, for the transmission of billing or payment information, rarely proves to be an important sticking point. However, this polarity could be somewhat overstated. EDI, reporting, and claims handling, while not singled out by shippers as primary concerns, are all aspects of the carrier's service capabilities, which shippers named as their number one negotiating topic. ■

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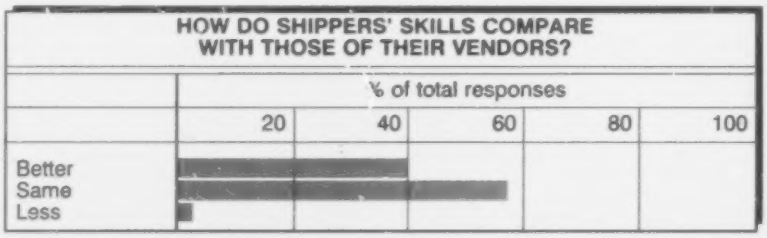
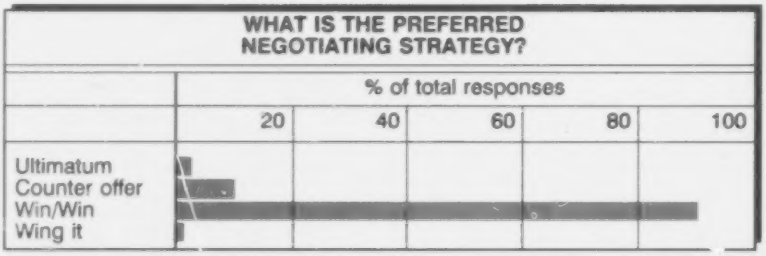
chart 3



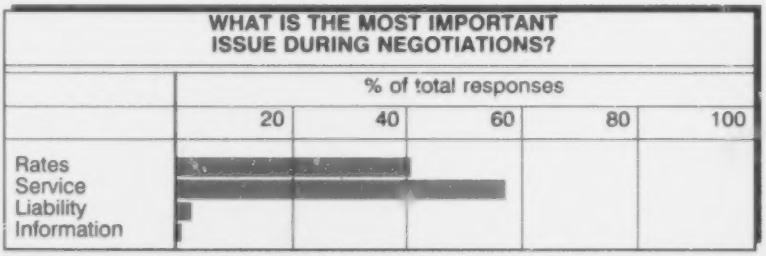
Shippers tend to view themselves as successful in dealing with their carriers. This success may be due to superior negotiating skills, but it could also reflect a market which currently favors the shipper.

chart 4



Nearly all shippers subscribe to the win/win approach to carrier negotiations. Also, they stress the need to enter negotiations armed with information.

chart 5



Nearly all the discussion occurring at the negotiating table is centered around rate and service levels. In practice, these two issues are not dealt with separately, but are closely tied together in price/service packages.

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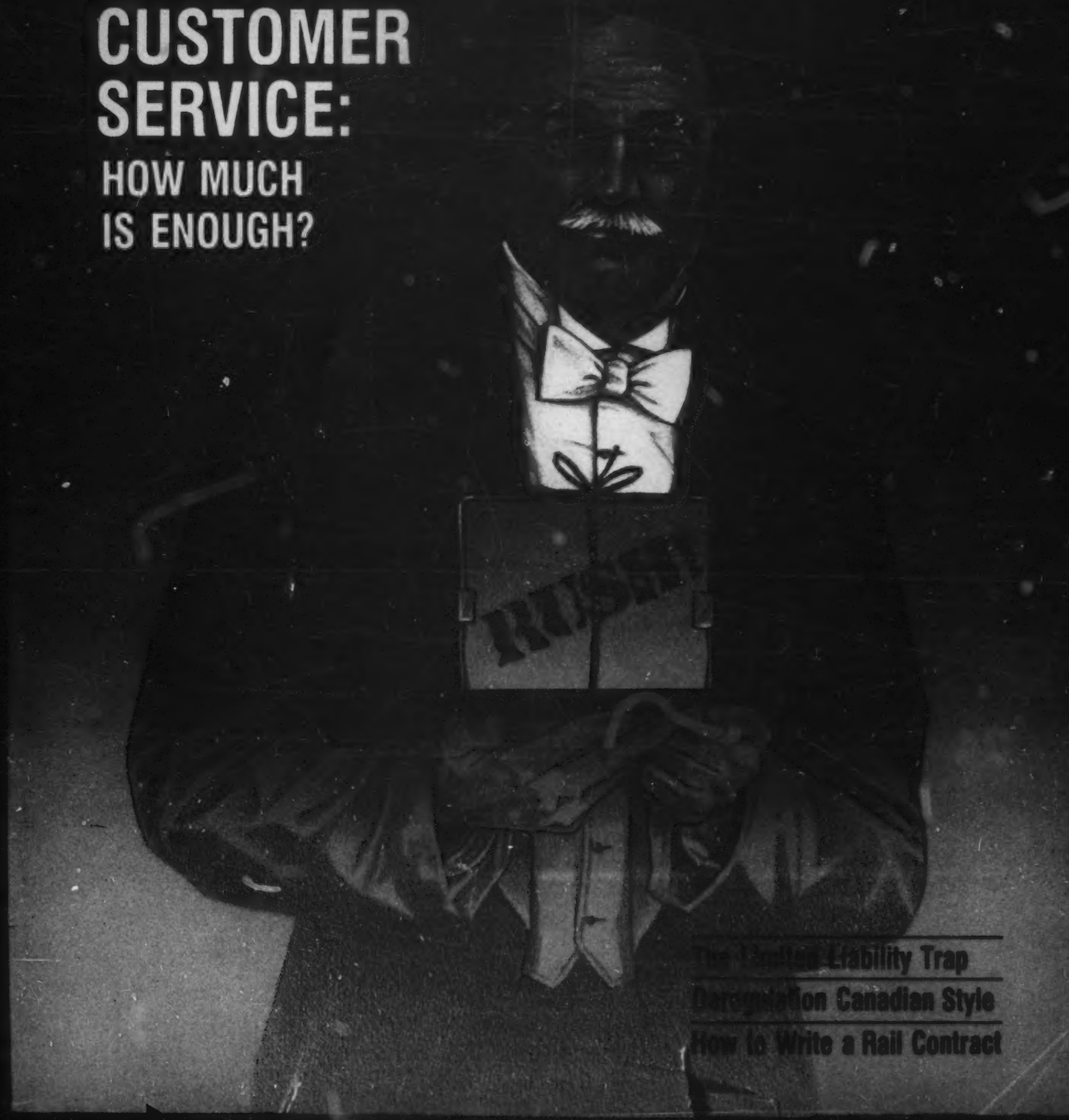

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Deregulation Canadian Style

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LOGISTICS CONTRACTS: FOR BETTER OR WORSE?

Shippers say this is the day of the contract, and that's just fine by them.

The answers shippers gave to the Dialogue questions posed in DISTRIBUTION's December 1987 issue are a conspicuous traffic sign pointing the way to the new route in shipper/carrier service. It is clear from what readers have said that contracting for transportation is becoming (and in fact for many respondents it has already) the preferred way of doing business with their distribution service partners.

As little as five years ago, transportation contracts were virtually unknown to more than half of the survey respondents, and none of them moved as much as half of their freight under a contractual agreement with a carrier. Today, the average respondent moves 55 percent of his shipments according to contract terms (see chart 1). A number of them have contracts governing 100 percent of their product moves, and many more have contracts to cover between 70 and 90 percent of their transportation volumes.

It's not hard to understand why these companies have embraced contracting to such a degree. Contracts are viewed as a means not only of assuring continued long-term quality service; they also are being

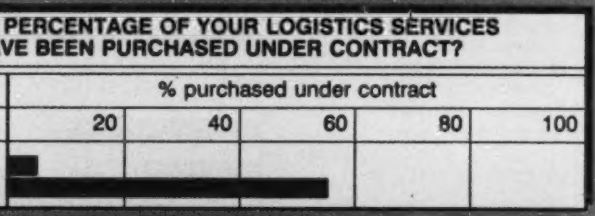
For over three years...

used to achieve a whole spectrum of other benefits (see chart 2 on page 12). Among these are the lower rates available to shippers who can commit to a minimum volume of freight, the guaranteed availability of equipment in sufficient quantities, and better integration of carrier and warehousing considerations into an overall logistics strategy. Of these, rate leverage was cited most often by respondents, but not to the exclusion of the others by any means.

Shippers also added such factors as customization of services, rate simplification, and reductions in the size and expense of private fleets as important reasons for arranging contracts with carriers. Shippers are attracted to contracts for a wide variety of reasons, according to Robert Markatos, senior logistics manager for CPC International. "Contracts are negotiated and used to establish future hedge positions, service levels, equipment needs, and total costs for sales and marketing needs," Markatos says. He adds that he doesn't commit all of his freight to contracts, but allows a certain amount to go uncontracted as a hedge for spot prices.

chart 1

WHAT PERCENTAGE OF YOUR LOGISTICS SERVICES HAVE BEEN PURCHASED UNDER CONTRACT?



The dependence on contracts as a means of securing distribution services has blossomed in the past half decade. Not only has the percentage of services purchased under contractual agreements grown from 5.5 percent to 55.1 percent, but the number of shippers relying on contracts also has increased substantially.

The Other Side of the Coin

There also are some problems that have arisen with the increased dependence on contracts within the respondents' companies (see chart 3 on page 13).

The most significant of these seems to be that the shippers who have negotiated contracts later find

continued

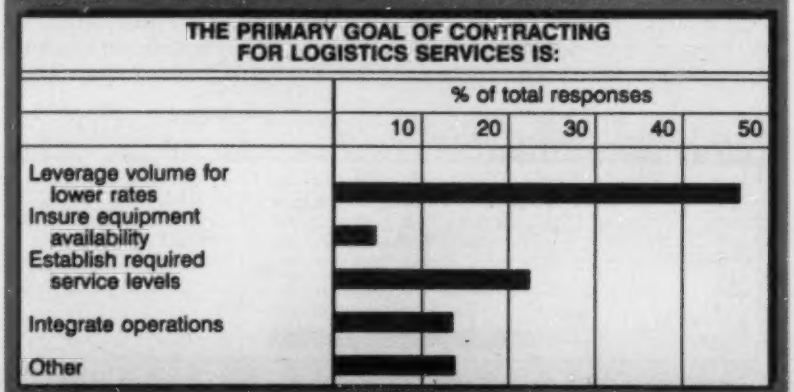
we've been moving successfully...

that the volumes promised to their carriers aren't being delivered. A plurality of 28 percent of the readers indicated that this was their major concern. Coupled with the fact that nearly half of the respondents also viewed rate leverage as the major benefit of transportation contracts, it would seem that too many shippers are promising carriers the world in order to get the best possible rate quote, without enough regard for the realities of their own operations.

Interestingly, while over a quarter of those responding to the survey named their own inability to meet terms as the number one problem involved in contracting, only about one-sixth placed the burden of guilt on their carriers.

More encouraging is the fact that roughly half of all the problems the respondents are facing are of the sort that are easily ironed out over time as the two contracting parties grow accustomed to their relationship. While the survey did not directly address the question, it might be assumed that transportation contracts are like marriages in that they are usually successful if they can survive those first few tumultuous years.

chart 2



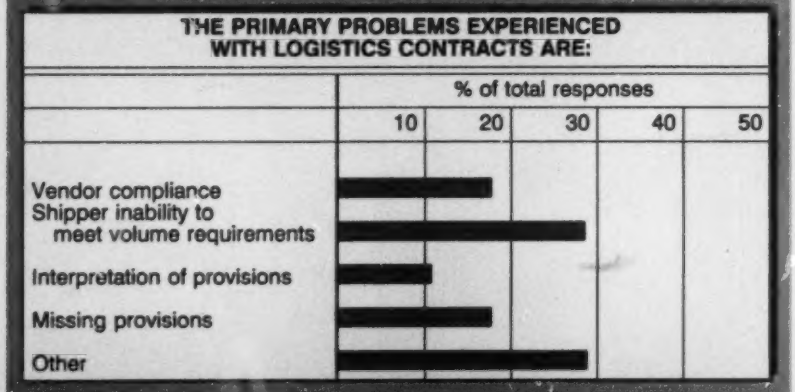
There are clearly a number of popular reasons for negotiating transportation contracts. Leveraging to gain lower rates is the most widespread goal, but establishing service levels and integrating transportation and warehousing also are important to shippers.

to more U.S. cities...

Among the problems that are generally more easily rectified are clauses or provisions which were overlooked by both parties, and the interpretation of the clauses which were included. These problems are usually nothing that some further negotiation can't resolve. But as one reader implies, contract renewal and renegotiation can become a problem of its own if both parties didn't negotiate in good faith the first time around.

Overall, the problems associated with contracts seem to be minimal when compared to the success indicated by the survey respondents. According to Ron Osborne, traffic manager with Fisher Mills, Inc., the very fact that contracts are offered attracts carriers and encourages better relations. "I interview and select carriers that appreciate our flexibility, dependability and 'carrier-friendly' attitude," says Osborne. "In theory, they will like our business so much that we can expect premium service from our carriers at their lowest price levels. So far it's working." ■

Chart 3



Shippers have had some difficulty getting vendors to comply with contract terms, but more often it is their own inability to meet obligations that causes problems. This chart also points up the need to establish clear contract terms up front.

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and our biggest move is still ahead...

CUSTOMER SERVICE
HOW MUCH IS ENOUGH?

Too little means lost market share.
Too much means lost profit margins.
The upshot is, you want
to be good—but not too good.

A DISTRIBUTION Staff Report

It was almost 12 years ago that the Council of Logistics Management first studied the practice of customer service. It found that customer service was indeed an important part of the marketing mix for most firms; yet it also discovered that the vast majority of these companies were not able to translate customer service performance into a competitive advantage.

There were two reasons for this. First, firms didn't have a reliable means of measuring their customer service, and so didn't really know what service levels they were providing. Second, companies didn't know how to control the customer service process to ensure consistent performance.

As a result, many firms became customer service maniacs. They provided service levels they were sure would exceed the customer's expectations. They responded to fears of poor service by stocking more inventory at more locations. In short, they threw money at the problem.

Companies have since realized they can't afford to serve customers that way. Information has taken the place of inventory, and customer service has become an integral part of firms' strategic planning and competitiveness. It is now the preferred method of differentiating a product from that of a competitor.

A decade after its original study, CLM has researched the subject of customer service again. Three faculty members from the Ohio State University's College of Business—Dr. Bernard J. LaLonde, Dr. Martha C. Cooper and Dr. Thomas G. Noordewier—worked together on the most recent project. While customer service theory and practice continue to be defined and refined in all quarters of the logistics industry, the CLM's study represents the most significant research on the subject to date.

The study contains eight major conclusions about how customer service increasingly is driving not only distribution, but the entire marketing mission of the nation's leading companies. Lending credence to the study's conclusions is the fact that other leading consultants and major shippers have arrived at many of the same conclusions.

• **Customer service has moved from a descriptive/reactive activity of the 1970s to a proactive/management activity of the 1980s.** A good example of this is the way in which the definition of customer service has evolved. Most of the respondents to the 1976 study defined customer service in a narrow context, either as a specific function (order entry, for example) or as a performance standard. In 1987, study participants describe customer service more as a process, whereby value is added to the product and each party in the transaction comes out ahead.

Management has definitely changed the way it views this customer service process. According to logistics consultant Herbert W. Davis, management has long had the misconception that the only way to improve customer service was to spend lots of money on more warehouses, more safety stock and expedited transportation. "Nothing could be further from the truth," says Davis, who is president of Herbert W. Davis Co., Englewood Cliffs, N.J. "The key to good customer service is better control over the distribution system."

For example, fill rates are one of the most important measures of customer service. A company that has precise information about its inventory, good forecasts, well-planned stock location and an ability to coordinate orders with transportation and distribution will always have good fill rates. At the same time, such a well-run company will never have too much inventory or stock in the wrong warehouse because this same information will allow it to control its inventory and all the costs associated with it.

• **Customer service performance expectations are evolving into a window of acceptable performance rather than a specific point or hurdle.** Performance below minimum standards may result in punitive actions by the buyer, yet performance above the expected level *may not* result in increased market share.

Customer service levels vary within an acceptable range rather than at a specific point. In addition, these acceptable service levels will vary by industry. James C. Spira, president of Cleveland Consulting Associates, says that niche marketing is the way of the future; smaller lots aimed at specific customer groups. This, in turn, will demand niche distribution: faster turnarounds, less inventory, more and better communication between customer and vendor. In short, a higher level of service. "You can't have a mass distribution mentality and still have a competitive advantage," says Spira.

The Eastman Kodak Company is a good example of this. According to Alex Bezney, director of customer operations support, Kodak used to provide more or less generic customer service. "We did not differentiate between business units. We did not differentiate between big and small customers," he says. "We said, 'We're going to treat all customers alike.' Pretty soon it became apparent that you can't treat them alike."

As a result, service levels can vary widely from market to market, according to needs. "For example," says Bezney, "a photo finisher, if he runs out of paper, he has to send his people home. If a retailer runs out of film for amateur photographers, it's not as crucial. Of course we don't want him to run out of film, but it's not as crucial as sending people home."

Like many respondents in the first CLM study, Kodak used to grade its customer service almost solely on one performance standard: how fast it got an order out. "All of a sudden everyone's saying, 'Get it out as fast as possible," says Bezney. "That's all wrong. Some business units are interested in getting orders out as soon as possible. But there's a cost associated with that. Other business units say, 'We are eminently satisfied if you get the order out in three days.' If you put it in perspective, different markets have different needs. If they're happy when we get it out in three days, why knock ourselves out to get it out the same day?"

continued

The danger there is obvious. When you continually crank out orders the same day, Bezney adds, "the dealer may conclude that he doesn't have to carry any inventory. So it's a balancing act. You want to be good, but not that good. You don't want be continually expediting orders day after day."

• **Information has moved center stage in providing efficient and effective customer service.** Accurate and timely information has become the single most important ingredient in effective customer service. Almost 1 out of 10 orders requires some order status information before it is delivered. A third of the respondents to the CLM study provide this information in less than 10 minutes. The rest average 14 hours.

"The first thing companies have to do is develop information systems that have decision science technology," says Spira. These systems not only accept data, they massage it and make recommendations for action based on it. "They allow better and faster decisions," says Spira. "They evaluate tradeoffs much faster." For example, in some cases these systems can select the optimum carrier for a shipment almost simultaneously with the order entry process. The result of all this, Spira says, is that "customers perceive you to be more flexible, but you're actually making better decisions for both of you."

A major tenet of high level customer service, he notes, is that the expense of computerized "decision science" is offset by the ability to better develop the most low-cost, flexible response. "Ten years ago," Spira says, "the goal of an order-entry system was to process the order. Now the goal is to manage the service offering."

• **A significant amount of change in logistics systems is buyer-driven rather than seller-driven.** Pressure for customer service performance comes from the customer. Buyers are using new technology, such as EDI and bar coding, to track product and service performance in a real-time environment. Many firms are being forced into using EDI by their customers.

The power of information is helping Kodak do a better job of determining what the customer needs, as opposed to what *it* thinks the customer needs. For example, the

continued

Table 3.1

Elements of the Marketing Mix
1976 vs. 1987

ELEMENT	1976	1987	% CHANGE
Product	36	33	– 14.9
Price	23	30	+ 30.4
Customer Service	23	23	NC
Advertising, Selling, Promotion	18	14	– 22.2
Total	100	100	—

Table 3.2

Elements of the Marketing Mix
1987 vs. 1990

ELEMENT	TODAY	1990	% CHANGE
Product	33.3	32.7	– 1.8
Price	29.9	28.8	– 3.7
Customer Service	22.4	24.9	+ 11.2
Advertising, Selling, Promotion	14.4	13.6	– 5.5
Total	100.0	100.0	

The focus on price (Table 3.1) suggests that many U.S. companies are having trouble being competitive. In the near future, customer service considerations will rise significantly in importance (Table 3.2).

company now has a much more accurate knowledge of what its distribution and customer service costs are. "Now they see exactly what we're charging them for," says Bezney. "Before, it was part of the corporate picture. The distribution division was almost in a policing role." That created some uncomfortable moments for the distribution group. "We were at a disadvantage because the business unit would say, 'Why can't you supply that service? That is something we need,' " says Bezney. "We would say, 'Well, it costs a lot.' Well, what does it cost? 'We don't know.' That encouraged them to ask for the moon.

"Now when they come to us and say, 'We need this,' we're no longer in a reactive mode; we're not trying to talk them out of it. We say, 'Here's what it costs. Do you still want it?' Many times they say, 'Whoa, I don't think we do.' Now we tell them how many people it will take to provide a certain level of customer service, and they decide whether they think it's worth the investment."

The shift toward a more customer-driven service posture also is causing companies to examine the way their inventory is deployed. "If you proliferate your entire inventory to all your stocking locations, you spread yourself too thin," says Bezney. "If you consolidate inventory, or at least part of it, in one or two central locations, then you can improve your product availability."

Kodak currently has five regional distribution centers, in Los Angeles, Chicago, Rochester, N.Y., Dallas and Atlanta. They also have two central DCs, in Rochester and Windsor, Colo. The company carries most of its product line at all locations, but that may not be the case for long. Kodak is contemplating an A-B-C inventory deployment. Demand for A items is high and fairly constant. Demand for B and C items is highly variable.

"If you're going to stock some (B and C items) in LA, some in Chicago, some in Rochester, some in Dallas, and some in Atlanta, there is a high probability of having product in the wrong place, based on demand variability," Bezney says. "The customers are telling us that product availability is crucial. Our job is to improve product availability through logistical considerations, and the A-B-C concept is one of them."

• **Contractual-driven systems, rather than transactional-driven systems, are becoming the dominant mode in many logistics systems.** There is a strong movement toward contractual relationships in transportation and public warehousing. This trend is further strengthened by the growth of JIT and EDI. Also, customer service performance is becoming a focus of negotiation between buyer and seller. This can result in "tailored" customer service for an individual customer.

But it also can result in headaches. JIT and zero inventory techniques have dramatically altered the way companies do business. Orders are much smaller, but also much more frequent. The point here, according to Herb Davis, is that there is a greater chance the manufacturer will have a stock out when an order comes in. Or that there will be a transportation failure.

"Very simply," says Davis, "there is more opportunity for everything in the customer service cycle to go wrong. It is this vulnerability to customer service problems that makes the function of customer service so important today. It is the function of customer service to deal successfully with smaller and more frequent orders. For those companies used to doing things as they always have, the transition to a system based on customer service is quite painful."

Cleveland Consulting's James Spira and Kodak's Alex Bezney see the shift toward contractual relationships

continued

Figure 8.1

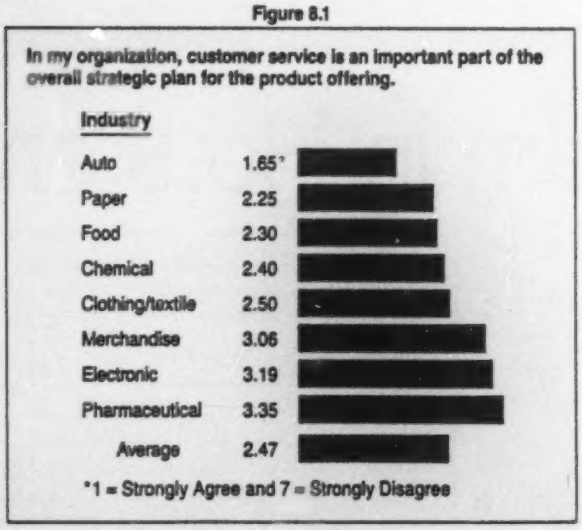
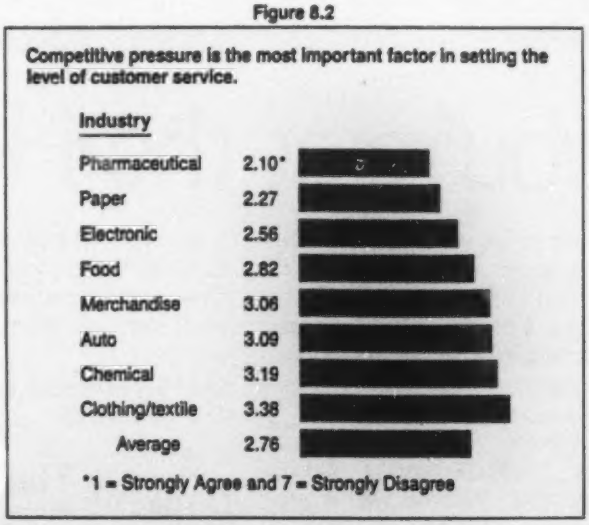


Figure 8.2



Companies have become comfortable using customer service as a strategic weapon instead of just an operational tool (Fig. 8.1). Also, customer service is seen as a key to differentiating products (Fig. 8.2).